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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

OAKLAND DIVISION

DALE BOZZIO, individually and on behalf of all other similarly situated, Plaintiff, vs. EMI GROUP LIMITED; CAPITOL RECORDS, LLC; EMI MUSIC NORTH AMERICA, LLC; EMI RECORDED MUSIC; and EMI MARKETING, Defendants.	Case No. 4:12-cv-2421 YGR Assigned to: Hon. Yvonne Gonzalez Rogers **DEFENDANT CAPITOL RECORDS, LLC'S SUPPLEMENTAL BRIEF IN SUPPORT OF ITS MOTION TO DISMISS FIRST AMENDED CLASS ACTION COMPLAINT FOR FAILURE TO STATE A CLAIM UNDER FEDERAL RULE OF CIVIL PROCEDURE 12(b)(6)** Date: October 2, 2012 Time: 2:00 p.m. Place: TBD

The Court's August 27, 2012 Order Vacating and Continuing Hearing On Motion To Dismiss (the "Order") directed the parties to submit supplemental briefs addressing two questions:

> (1) Has Plaintiff pleaded facts sufficient to establish a basis for avoiding a specific contractual bar on proceeding directly against Capitol based upon waiver or estoppel?
>
> (2) Even if Plaintiff has pleaded facts sufficient to establish a basis for avoiding any contractual provisions that would preclude a direct lawsuit by Plaintiff, should Plaintiff be permitted to proceed directly against Capitol if the loan-out company that is the party to the agreements with Capitol is a suspended corporation? If the loan-out corporation is controlled by Plaintiff, why should Plaintiff be allowed to sidestep the corporate form and obligations?

The answer to both questions is "no."

As to the first question, Plaintiff's allegations stand in stark contrast to the facts in *Clinton v. Universal Music Group, Inc.*, 376 F. App'x 780, 781 (9th Cir. 2010), which the Court cited in the Order. Unlike the parties in *Clinton*, Capitol has not dealt "directly" with Plaintiff so as to waive its rights to enforce the agreements at issue here. Indeed, Plaintiff has not alleged *any* facts showing that Capitol has dealt with Plaintiff individually in connection with the relevant artist agreements. Instead, the most that Plaintiff alleges is that Capitol dealt with her with respect to entirely distinct agreements, not at issue here, relating to publishing royalties for songs that she composed.

As to the second question, the California Revenue and Taxation Code expressly precludes a suspended corporation such as Missing Persons, Inc., which is the party to the operative agreements with Capitol, from prosecuting a lawsuit. Indeed, a suspended corporation cannot participate in litigation in any respect until the corporation has been revived, including through the payment of all taxes and fees owed. *See* Cal. Rev. & Tax. Code §§ 23301, 23305. Permitting Plaintiff, who claims to be the sole owner of Missing Persons, Inc., to sue Capitol directly would constitute an end-run around these provisions, and would undermine the important public policy considerations that underlie them. Such an end-run should not be countenanced by this Court.

A. Plaintiff Has Not Alleged Facts Establishing Waiver Or Estoppel.

In order to establish waiver of a contractual right, "there must be a clear, unequivocal, and decisive act showing the party's purpose or acts amounting to an estoppel." *A.J. Indus., Inc. v. Ver Halen*, 75 Cal. App. 3d 751, 759 (1977); *Rennie & Laughlin, Inc. v. Chrysler Corp.*, 242 F.2d 208, 211 (9th Cir. 1957) (rejecting waiver argument: "Where substantive rights are involved, it is said frequently that waiver must be supported by either an agreed consideration or by acts amounting to an estoppel."). Similarly, in order to plead estoppel, Plaintiff must allege four elements:

> (1) that the party to be estopped was apprised of the facts; (2) that he intended his conduct to be acted on, or that he acted in such a way that the party asserting estoppel reasonably could believe that he intended his conduct to be acted upon; (3) that the party asserting estoppel was ignorant of the actual facts; and (4) that the party asserting estoppel relied upon the conduct to his injury.

American Casualty Co. v. Baker, 22 F.3d 880, 891-92 (9th Cir. 1994) (internal quotations and citations omitted); *Colony Ins. Co. v. Crusader Ins. Co.*, 188 Cal. App. 4th 743, 751 (2010) (same). Plaintiff's FAC does not contain *any* – much less sufficient – facts that would support a claim of waiver or estoppel, and thereby allow Plaintiff to overcome the express contractual bar on direct actions against Capitol. And it certainly does not contain the concrete allegations that the district court in *Clinton v. Universal Music Group, Inc.* held were necessary to invoke the doctrine of waiver. *See Clinton v. Universal Music Group, Inc.*, No. CV 07-672 PSG (JWJx) (C.D. Cal., July 26, 2007) ("*Clinton I*"), *slip op.* at 9-10 (attached hereto as Exhibit A), *aff'd on summ. jmt.*, 2008 WL 2491699 (C.D. Cal. Jun. 19, 2008), *aff'd*, 376 F. App'x 780 (9th Cir. 2010) ("*Clinton II*").

The relevant agreements unequivocally prohibit Plaintiff from bringing a claim for unpaid royalties directly against Capitol. In the Original Agreement, Plaintiff agreed "to look solely to the partnership 'Missing Persons' for payment of all royalties and/or fees, as the case may be, and will not assert any claim in this regard against Capitol …." FAC, Ex. A, p. 34, ¶ 1.a. Later, Plaintiff formed Missing Persons, Inc., and that entity was substituted as the contracting party with Capitol. FAC ¶ 49. The corresponding Loan-Out Agreement likewise stated that Plaintiff "[a]gree[d] to look solely to [Missing Persons, Inc.] for the payment of [their] fees and/or royalties, as the case may be, and will not assert any claim in this regard against Capitol …." *Id.*, Ex. B, p. 6, ¶ 1.d.

In an effort to avoid this express contractual bar, Plaintiff has argued that Capitol "induced [her] reasonable belief" that it had relinquished its right to enforce this limitation, and has cited *Clinton* in support. Dkt. No. 20 at 8. In *Clinton*, the loan-out company of plaintiff George Clinton, a recording artist, entered into a recording agreement with Casablanca Records, Inc. In connection with the recording agreement, Casablanca agreed to pay royalties to the loan-out company, and Clinton agreed to "look solely to [his loan-out company] for any and all royalties, recording fees and other monies which may be payable to [Clinton]," and that he would "not assert any claims for such monies against" Casablanca Records. *Clinton I*, *slip op.* at 9. Despite these provisions, Casablanca or its successors "sent royalty statements and payments directly to the Plaintiff" for a period of five years. *Id*. The "majority of these checks were allegedly addressed to Plaintiff," and the rest were made out to the plaintiff's managers or attorneys; none was made out to the loan-out corporation. *Id.* Clinton also alleged that he gave the record company notice of his intention "as the artist" to conduct an audit relating to the recording agreement, and that the record company allowed him to conduct the audit. *Id.* Moreover, the record company responded to Clinton's audit report, "which identified the Plaintiff [Clinton] as the individual party," and "admit[ed] that more than $155,000 in artist royalties were due and owing *to Plaintiff*." *Id.* at 9-10 (emphasis added). In addition, there were a total of ***nine*** "letters from [the record company] to Clinton's representatives" dealing with the key issue in that case – tolling of limitation periods. *See Clinton II*, 376 Fed. App'x at 782. The Court held that these allegations raised a question of fact "as to whether [the record company's] acts induced Plaintiff's reasonable belief" that the record company's right to enforce the contractual bar on claims had "been relinquished." *Clinton I*, *slip op.* at 10.

No such facts are alleged here. Plaintiff has not alleged that Capitol dealt with her as an individual in connection with the recording contracts at issue; Plaintiff has not alleged that Capitol sent "royalty statements and payments" relating to the recording contracts to her directly; Plaintiff has not alleged that Capitol made out artist's royalty checks to her directly; Plaintiff has not alleged that she, "as the artist," ever exercised any audit right; and Plaintiff has not alleged that Capitol has ever admitted that royalties are "due and owing to Plaintiff." In sum, to the extent *Clinton* sets the standard for a finding of waiver or estoppel, Plaintiff's FAC falls woefully short.

Despite these failures, Plaintiff argues that her allegations in paragraphs 90 and 91 of the FAC establish that Capitol dealt directly with her regarding the Original and Loan Agreements. However, these allegations actually refute her claim. Plaintiff alleges that in 1985 and 1986, "Capitol Records and Missing Persons, Inc. entered into a series of four agreements concerning advances against artists royalties otherwise payable pursuant to the [Original and Loan-Out Agreements]." FAC ¶ 90. She further alleges that certain of those advances were recoupable from publishing income otherwise due to her "individual publishing entity, Life After Music," and that she therefore signed the agreements on behalf of Life After Music. FAC ¶ 90. Plaintiff also alleges that Capitol has sent "*publisher* royalty statements and payments for Missing Persons *songs* directly to Dale Bozzio." FAC ¶ 91 (emphasis added)

These allegations in no way establish either waiver or estoppel with respect to performance under the relevant *recording* contracts. This case has nothing to do with the payment of publishing royalties, or with Capitol's interactions with Plaintiff respecting such publishing royalties; instead, it is about *artist* royalties for Missing Persons recordings, under Capitol's agreements with Missing Persons, Inc. *See* FAC ¶ 2; *id.* at Ex. A, p. 3, ¶ 3. There is a clear distinction: publisher royalties derive from authoring musical compositions (FAC ¶¶ 90-91), while artist royalties derive from use of master recordings (FAC, Ex. A, p. 3, ¶ 3), and separate agreements govern these different relationships.[1] Accordingly, it does not matter how Capitol interacted with Plaintiff in connection with *publisher* royalties; what matters is that, following execution of the Loan-Out Agreement, Capitol never dealt directly with Plaintiff in connection with the recording contracts at issue here.

Indeed, the very documents upon which Plaintiff relies prove Capitol's point. *See* FAC, Exs. C-D. The agreements attached as Exhibit C to the FAC were between Capitol and *Missing Persons, Inc.*, with reference to the recording contract between Capitol and *Missing Persons, Inc.*, and were signed in the name of *Missing Persons, Inc.* – not Plaintiff – by someone other than Plaintiff. *See id.* Plaintiff's signature appears only as the representative of her "individual publishing entity, Life After Music," and not on behalf of Missing Persons, Inc. *Id.* Similarly, the royalty statements attached to the FAC as Exhibit D relate solely to "publisher royalties" due to Life After Music, not to artist royalties due to Missing Persons, Inc. Nowhere in these documents did Plaintiff purport to act on behalf of Missing Persons, Inc., and nowhere in these documents did

[1] *See* E. Scott Johnson, *Long & Winding Road: Music Royalties*, 37-JUN Md. B.J. 33, 34 (2004) ("Earnings in the recording industry principally flow from the two copyrights – sound recording and musical composition – that coexist in recorded music. Sound recording copyrights protect the actual recorded performances and sounds on the master recordings, and derive from the performances and creative contributions made by the performers and producers of the recordings. . . . The musical compositions embodied in sound recordings are separately copyrightable and derive from the authorship of the songwriter.").

Capitol treat Plaintiff as interchangeable with Missing Persons, Inc. Instead, both Plaintiff's allegations and the undisputed evidence show that Capitol dealt directly, and exclusively, with Missing Persons, Inc. respecting the recording contracts at issue, even as it separately dealt with Plaintiff respecting her individual publishing rights. *See* FAC, Exs. C-D; Decl. of John Ray in Supp. of Def.'s Motion to Dismiss (Dkt. No. 5), Exs. A, F-L.[2]

Plaintiff's allegations therefore fail to raise any question of fact as to waiver or estoppel – there is simply no basis for a finding that Capitol has acted in a manner "so inconsistent with an intent to enforce [its] right as to induce a reasonable belief that such right has been relinquished." *Intel Corp. v. Hartford Acc. & Indem. Co.*, 952 F.2d 1551, 1559 (9th Cir. 1991). Accordingly, the unequivocal terms of the operative agreements should be enforced to bar Plaintiff's claims against Capitol. *Skilstaf, Inc. v. CVS Caremark Corp.*, 669 F.3d 1005, 1017 (9th Cir. 2012).

B. Allowing Plaintiff To Maintain Royalty Claims Contravenes The Public Policy Underlying California's Revenue And Taxation Code.

Even if Plaintiff had alleged facts that would support a finding of waiver or estoppel, she cannot invoke these equitable doctrines here. It is well established that a party may not rely upon doctrines of estoppel or waiver where to do so would violate public policy, including the public policy considerations underlying California's Revenue and Taxation Code. *See* Cal. Civ. Code § 3513 (prohibiting waiver of "a law established for a public reason"); *Panzer-Hamilton Co. v. Bray*, 96 Cal. App. 460, 463-65 (1929) (holding that "estoppel cannot operate as against positive law or public policy" that precludes a corporation from bringing an action). Indeed, California has declared "unlawful" contracts that purport to authorize conduct "[c]ontrary to the policy of express law" (Cal. Civ. Code §§ 1667, 1668), and courts will not allow litigants to claim waiver as to matters – including violations of law or public policy – that a party cannot contractually waive. *Stuart v. Radioshack Corp.*, 259 F.R.D. 200, 202 (N.D. Cal. 2009) (rejecting claim of waiver as contrary to public policy, and noting that waiver of a law that is "'enacted for a public reason should not depend on the happenstance whether the waiver was incorporated in an agreement' or accomplished in another manner") (quoting *Covino v. Governing Board*, 76 Cal. App. 3d 314, 322-23 (1977)); *accord* Cal. Civ. Code § 1668 (prohibiting parties from agreeing to excuse a "violation of law").

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[2] These facts also serve to further distinguish *Clinton*. There, each allegation of direct dealing by the record company related to the recording agreements that were directly at issue in that litigation. *Clinton I*, *slip op.* at 9-10.

Plaintiff admits that she "created" Missing Persons, Inc. as her loan-out corporation. In so doing, she took advantage of the corporate form to limit her liability and obtain tax advantages. Having elected the corporate form, however, Plaintiff must comply with the concomitant obligations. *See W. States Bankcard Ass'n v. Cty. and Cnty. of San Francisco*, 19 Cal. 3d 208, 220 (1977) ("Having chosen [the] corporate form for its peculiar benefits, the [corporation's members] may fairly and reasonably be required to accept the tax burdens necessarily attendant upon that form."); Cal. Civ. Code § 3521. Relevant here, if a corporation becomes suspended, California does not permit the corporation to prosecute actions until reinstated. Cal. Rev. & Tax. Code §§ 23301, 23305; *Kaufman & Broad Communities, Inc. v. Performance Plastering, Inc.*, 136 Cal. App. 4th 212, 217-18 (2006) ("a suspended corporation cannot sue or defend a lawsuit"); *Palm Valley Homeowners Ass'n, Inc. v. Design MTD*, 85 Cal. App. 4th 553, 560 (2000) (suspended corporation "disabled from participating in any litigation activities").

The long-standing policy and purpose behind this rule is to ensure that corporations comply with their obligations, including to pay taxes. *Kaufman*, 136 Cal. App. 4th at 218; *Peacock Hill Ass'n v. Peacock Lagoon Const. Co.*, 8 Cal. 3d 369, 371 (1972) ("the purpose of section 23301 . . . is to put pressure on the delinquent corporation to pay its taxes").[3] And where Plaintiff is responsible for both the suspension of Missing Persons, Inc., and the failure to satisfy the tax obligations and revive the company, she should not be allowed to circumvent this public policy by suing Capitol directly. *See Amesco Exports, Inc., et al. v. Assoc. Aircraft Mfg. & Sales, Inc.*, 977 F. Supp. 1014 (C.D. Cal. 1997) ("*Amesco I*"), *order vacated on reconsideration*, 87 F. Supp. 2d 1013 (C.D. Cal. 1997) ("*Amesco II*"); *see also Tskvitishvilli v. Gas Invest Co.*, No. BC 335014, 2008 WL 744054 (Trial Order), at *1 (Cal. Super. Ct. Jan. 13, 2008) (dismissing claim by assignee of suspended corporation).

[3] The public policy against permitting individuals to assert the claims of inactive corporate entities is so firmly established that "[a]ny person who attempts or purports to exercise the powers, rights, and privileges of a corporation that has been suspended" is guilty of a crime punishable by a fine and imprisonment. Cal. Rev. & Tax. Code § 19719(a).

In *Amesco I*, the court confronted the exact issue before this Court and held that direct claims by an owner of a suspended corporation must be dismissed. There, the owner of a suspended corporation attempted to assert a claim based on a contract entered into by the corporation. *Amesco I*, 977 F. Supp. at 1015. The court observed that if the corporation's owner could "sue as an individual on the written contract, to which he is not a party, it would create a mechanism for him to get around the fact that the State of California has suspended AMESCO and *inter alia*, its right to sue." *Id.* at 1016. The court concluded:

> To allow that individual to sue on a contract signed only by the corporation would be to allow that person the benefits of a corporation without the limitations. If one wishes to preserve the right to sue as an individual in this situation, one may sign the contract as an individual.

Id.[4] Accordingly, the court dismissed the claim, *id.* at 1016-17, and only permitted the action to proceed when the plaintiff presented evidence that the corporation had been revived and was no longer suspended, *Amesco II*, 87 F. Supp. 2d at 1014-15.

The same analysis applies with equal force here. Just as in *Amesco I*, Plaintiff is attempting to assert claims based upon a contract entered into by a suspended corporation. Just as in *Amesco I*, the same public policies and rationale preclude her from doing so. And just as in *Amesco I*, Plaintiff is not "with[out] recourse;" nor are the members of Missing Persons forced to "su[e] their loan-out … for money none of them possesses;" nor is Capitol "receiv[ing] the artists' services for free." Dkt. No. 20 at 13-14. If Plaintiff believes that Missing Persons, Inc. is entitled to additional royalties, then she can reinstate Missing Persons, Inc. (and have Missing Persons, Inc. discharge whatever tax obligation it owes), and Missing Persons, Inc. can file an action. *Accord Amesco II*, 87 F. Supp. 2d at 1014-1015. But Plaintiff "chose to use the [loan-out] corporation as the signatory and [should] be held to the consequences of that decision." *Amesco I*, 977 F. Supp. at 1016.

For the foregoing reasons, the FAC should be dismissed.

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[4] The *Amesco I* court also rejected the proposition that the owner could sue as a third-party beneficiary, "because that would defeat the purpose of creating the corporation and using it as the signatory." *Amesco I*, 977 F. Supp. at 1016; *cf. Performance Plastering v. Richmond Am. Homes of Cal.*, 153 Cal. App. 4th 659, 669 (2007) (notwithstanding suspension of contracting party, allowing insurer that was third-party beneficiary of contractual release – but which was not responsible for creation or suspension of contracting party – to enforce release).

Dated: September 11, 2012

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